In the Supreme Court of the United States

OCTOBER TERM, 1970

No. 1011

CESAR E. ALVAREZ AND ANA I. ALVAREZ, PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The findings of fact and conclusions of law of the district court (Pet. App. 9–17) are not reported. The opinion of the court of appeals (Pet. App. 2–9) is reported at 431 F. 2d 1261.

JURISDICTION

The judgment of the court of appeals was entered on September 1, 1970 (Pet. App. 1–2). The petition for a writ of certiorari was filed on November 27, 1970. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

412-475—70

QUESTION PRESENTED

Whether the Cuban Government's confiscation in 1961 of an indemnification right, which had been previously granted to petitioner upon the seizure of his rental realty, resulted in a trade or business loss which may be carried over and deducted in subsequent years under Section 172 of the Internal Revenue Code of 1954.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 165 and 172 of the Internal Revenue Code of 1954 and of Sections 1.165–1 and 1.172–3 of the Treasury Regulations on Income Tax (1954 Code) are set forth in the Appendix, *infra*, pp. 9–16.

STATEMENT

Petitioner,[1] a Cuban citizen, owned an undivided half-interest in improved business realty in Cuba, which was rented to a number of tenants. The Cuban Government seized the property under the Urban Reform Law promulgated on October 14, 1960, which provided a limited indemnification right for former owners. Petitioner was given a nontransferable indemnification right of $22,400, payable at the rate of $200 per month for nine years and four months. He received eight payments prior to his final departure from Cuba on June 6, 1961. (Pet. App. 3, 5.)

On December 5, 1961, the Cuban Government promulgated "Law No. 989" confiscating all property

[1] References to "petitioner" are to Cesar E. Alvarez. Ana I. Alvarez is a party hereto only because joint income tax returns were filed for the years in issue.

rights of Cubans who failed to return to Cuba within a designated time unless they received permission to remain outside of Cuba. Since petitioner did not return to Cuba or receive permission from the Cuban Government to remain absent from Cuba, his indemnification right was confiscated. (Pet. App. 4.)

The district court held that petitioner, for tax purposes, suffered the loss of his rental property on December 5, 1961, the enactment date of "Law No. 989," and that the loss was a business loss which could be carried over to 1962 and 1963 under Section 172 of the Internal Revenue Code (Pet. App. 10–17). On appeal, the Fifth Circuit reversed. It held that after promulgation of the Urban Reform Law of October 14, 1960, petitioner had only the right to indemnification, a nonbusiness asset (Pet. App. 5), and that the loss of this indemnification right in December, 1961, was a nonbusiness loss which could not be carried forward to 1962 and 1963 under the net operating loss carryover provisions of Section 172 (Pet. App. 6–8).[2]

[2] The government submits that both the district court and the court of appeals erred as a matter of law in concluding that petitioner's indemnification right had any value to him after he became a resident alien. A taxpayer has the burden of proof to establish that he lost something of value, for which a deduction is allowable in the year it is claimed. *Boehm* v. *Commissioner*, 326 U.S. 287, 294; *James Petroleum Corp.* v. *Commissioner*, 238 F. 2d 678, 679–680 (C.A. 2). Petitioner failed to meet that burden. He testified that he had to be present in Cuba to receive the checks, and he stated that he would not go back to Cuba so long as Castro was in power. The value of his indemnification right to him thus turned upon unforeseen political events, and could not be proved. The judgment of the court of appeals could be sustained for this reason alone.

ARGUMENT

The decision below is correct. There is no conflict of decisions among the circuits or any other reason for further review by this Court.

1. The court of appeals correctly held that the loss was not a business loss deductible under Section 165 (c)(1) (Appendix, *infra*, p. 9) which could be carried forward under Section 172(a) (Appendix, *infra*, pp. 9–10). Before entering this country, petitioner had involuntarily exchanged his business realty for an indemnification right and after October 14, 1960, held only a right of indemnification. See *Hawaiian Gas Products* v. *Commissioner*, 126 F. 2d 4 (C.A. 9). That right was a nonbusiness asset separate and distinct from the property for which it had been given. The amount to be received from the Cuban Government for the seizure of the property was neither speculative nor indeterminate while petitioner remained in Cuba. In fact, petitioner did receive payments in accordance with the provisions of the Urban Reform Law when he was in Cuba.

The confiscation of the indemnification right on December 5, 1961, was unrelated to the seizure on October 14, 1960, and, therefore, the character of the loss suffered on December 5, 1961, cannot be determined by reference to the character of the realty seized on Octo-

ber 14, 1960.[a] There is no evidence that petitioner had a business in which he dealt in indemnification rights. Accordingly, petitioner's loss on December 5, 1961, of his indemnification right was not deductible as a business loss under Section 165(c)(1). Since nonbusiness losses may be utilized in determining a "net operating loss" deduction only to the extent of the nonbusiness income in the year of loss, there can be no carryover to the years in suit. See Section 172(d)(4) of the Internal Revenue Code, Appendix, *infra*, p. 11; Section 1.172–3(a)(3) of the Treasury Regulations on Income Tax (1954 Code), Appendix, *infra*, pp. 15–16.

Section 1.165–1(d)(2) of the Treasury Regulations

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[a] The situation here is distinguishable from that in *Arrowsmith* v. *Commissioner*, 344 U.S. 6. There, the loss involved stemmed from a judgment against a liquidated corporation. Had the judgment been paid by the corporation prior to its liquidation, the loss would have been a capital loss. This Court held that the mere fact that it was paid by the transferees of the corporation's assets several years after the corporation's liquidation did not change the character of the loss. The taking of petitioner's indemnification right on December 5, 1961, did not relate back to the taking of the realty on October 14, 1960. "Law No. 989" in no way modified the Urban Reform Law. If it had modified that law, an *Arrowsmith* situation would have arisen. But "Law No. 989" addressed itself to a different situation, namely to property of those Cubans who had left Cuba. Petitioner's situation in substance is no different than if he had received a promissory note for the purchase of his business realty. The exchange of the realty for the note would have constituted a taxable transaction for federal tax purposes. If the government then had seized his note, the characterization of the loss would not have been determined by reference to the transaction in which he received the note.

on Income Tax (1954 Code), Appendix, *infra*, pp. 12–14, cited by petitioner (Pet. 10), has no bearing on this case. That section of the Regulations and the example therein merely stand for the proposition that as long as a claim with respect to an otherwise deductible loss is in dispute, no deduction can be taken to the extent that there exists a reasonable prospect of recovery of the loss. But once the loss becomes fixed and final, as did petitioner's loss on his realty on October 14, 1960, there is no basis for characterizing a subsequent unrelated loss by reference to the character of the earlier loss.

The court of appeals properly rejected petitioner's claim under Section 453(d)(1) of the Code, which deals with the taxation of income from installment obligations (Pet. App. 7–8). This special section provides that the gain or loss upon the sale or exchange of an installment obligation is to be considered as resulting from the sale or exchange of the property for which the installment obligation was received. It is applicable only if a taxpayer makes a special election. See Treasury Regulations on Income Tax (1954 Code), Section 1.453–8(b); Rev. Rul. 65–297, 1965–2 Cum. Bull. 152. Petitioner made no such election.

Petitioner's claim (Pet. 8) that the court of appeals would "transform a business asset into a nonbusiness asset where a claim for compensation comes into existence" has no merit. Although he argues that the decision below is without statutory, judicial, or ad-

ministrative support (Pet. 8), he fails to cite any contrary authority.

2. While the issue here is presented in some 1,300 cases pending administratively and in the courts, involving over $3,000,000 in taxes, it is not ripe for review by this Court at this time. Petitioner admits that there is no conflict in the circuits, but relies on the district court's decisions in the consolidated cases of *Beltran* v. *United States* and *Onetti* v. *United States,* 69–2 U.S.T.C., par. 9649 (D.C. Ill.), now pending on appeal in the Seventh Circuit (Pet. 10). Unless the Seventh Circuit affirms *Beltran* and *Onetti,* thereby creating a conflict, there is no basis for review here.

CONCLUSION

The petition for a writ of certiorari should be denied. Alternatively, action on the petition should be deferred pending disposition of the *Beltran* and *Onetti* cases.

Respectfully submitted.

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DECEMBER 1970.

APPENDIX

Internal Revenue Code of 1954 (26 U.S.C.):

SEC. 165. LOSSES.

(a) *General Rule.*—There shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

(b) *Amount of Deduction.*—For purposes of subsection (a), the basis for determining the amount of the deduction for any loss shall be the adjusted basis provided in section 1011 for determining the loss from the sale or other disposition of property.

(c) *Limitation on Losses of Individuals.*—In the case of an individual, the deduction under subsection (a) shall be limited to—

(1) losses incurred in a trade or business;

(2) losses incurred in any transaction entered into for profit, though not connected with a trade or business; and

(3) losses of property not connected with a trade or business, if such losses arise from fire, storm, shipwreck, or other casualty, or from theft. No loss described in this paragraph shall be allowed if, at the time of the filing of the return, such loss has been claimed for estate tax purposes in the estate tax return.

* * * * *

SEC. 172 [as amended by Sec. 317(b), Trade Expansion Act of 1962, P.L. 87-794, 76 Stat. 872, and by Sec. 210(a), Revenue Act of 1964, P.L. 88-272, 78 Stat. 19]. NET OPERATING LOSS DEDUCTION.

(a) *Deduction Allowed.*—There shall be allowed as a deduction for the taxable year an amount equal to the aggregate of (1) the net

operating loss carryovers to such year, plus (2) the net operating loss carrybacks to such year. For purposes of this subtitle, the term "net operating loss deduction" means the deduction allowed by this subsection.

(b) *Net Operating Loss Carrybacks and Carryovers.*—

(1) *Years to which loss may be carried.*—

* * * * *

(D) In the case of a taxpayer which has a foreign expropriation loss (as defined in subsection (k) for any taxable year ending after December 31, 1958, the portion of the net operating loss for such year attributable to such foreign expropriation loss shall not be a net operating loss carryback to any taxable year preceding the taxable year of such loss and shall be a net operating loss carryover to each of the 10 taxable years following the taxable year of such loss.

* * * * *

(c) *Net Operating Loss Defined.*—For purposes of this section, the term "net operating loss" means (for any taxable year ending after December 31, 1953) the excess of the deductions allowed by this chapter over the gross income. Such excess shall be computed with the modifications specified in subsection (d).

(d) *Modifications.*—The modifications referred to in this section are as follows:

(1) *Net operating loss deduction.*—No net operating loss deduction shall be allowed.

(2) *Capital gains and losses of taxpayers other than corporations.*—In the case of a taxpayer other than a corporation—

(A) the amount deductible on account of losses from sales or exchanges of capital assets shall not exceed the amount includible on account of gains from sales or exchanges of capital assets; and

(B) the deduction for long-term capital gains provided by section 1202 shall no be allowed.

(3) *Deduction for personal exemptions.*—No deduction shall be allowed under section 151 (relating to personal exemptions). No deduction in lieu of any such deduction shall be allowed.

(4) *Nonbusiness deductions of taxpayers other than corporations.*—In the case of a taxpayer other than a corporation, the deductions allowable by this chapter which are not attributable to a taxpayer's trade or business shall be allowed only to the extent of the amount of the gross income not derived from such trade or business. For purposes of the preceding sentence—

(A) any gain or loss from the sale or other disposition of—

(i) property, used in the trade or business, of a character which is subject to the allowance for depreciation provided in section 167, or

(ii) real property used in the trade or business,

shall be treated as attributable to the trade or business;

(B) the modifications specified in paragraphs (1), (2)(B), and (3) shall be taken into account; and

(C) any deduction allowable under section 165(c)(3) (relating to casualty losses) shall not be taken into account.

* * * * * *

Treasury Regulations on Income Tax (1954 Code) (26 C.F.R.):

§ 1.165–1 *Losses.*

(a) *Allowance of deduction.* Section 165(a) provides that, in computing taxable income under section 63, any loss actually sustained during the taxable year and not made good by insurance or some other form of compensa-

tion shall be allowed as a deduction subject to any provision of the internal revenue laws which prohibits or limits the amount of the deduction. This deduction for losses sustained shall be taken in accordance with section 165 and the regulations thereunder. For the disallowance of deductions for worthless securities issued by a political party, see § 1.271–1.

(b) *Nature of loss allowable.* To be allowable as a deduction under section 165(a), a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and, except as otherwise provided in section 165(h) and § 1.165–11, relating to disaster losses actually sustained during the taxable year. Only a bona fide loss is allowable. Substance and not mere form shall govern in determining a deductible loss.

(c) *Amount deductible.* (1) The amount of loss allowable as a deduction under section 165 (a) shall not exceed the amount prescribed by § 1.1011–1 as the adjusted basis for determining the loss from the sale or other disposition of the property involved. In the case of each such deduction claimed, therefore, the basis of the property must be properly adjusted as prescribed by § 1.1011–1 for such items as expenditures, receipts, or losses, properly chargeable to capital account, and for such items as depreciation, obsolescence, amortization, and depletion, in order to determine the amount of loss allowable as a deduction. To determine the allowable loss in the case of property acquired before March 1, 1913, see also paragraph (b) of § 1.1053–1.

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(d) *Year of deduction.* (1) A loss shall be allowed as a deduction under section 165(a) only for the taxable year in which the loss is sustained. For this purpose, a loss shall be treated as sustained during the taxable year in which the loss occurs as evidenced by closed and com-

pleted transactions and as fixed by identifiable events occurring in such taxable year. For provisions relating to situations where a loss attributable to a disaster will be treated as sustained in the taxable year immediately preceding the taxable year in which the disaster actually occurred, see section 165(h) and § 1.165–11.

(2)(i) If a casualty or other event occurs which may result in a loss and in the year of such casualty or event, there exists a claim for reimbursement with respect to which there is a reasonable prospect of recovery, no portion of the loss with respect to which reimbursement may be received is sustained, for purposes of section 165, until it can be ascertained with reasonable certainty whether or not such reimbursement will be received. Whether a reasonable prospect of recovery exists with respect to a claim for reimbursement of a loss is a question of fact to be determined upon an examination of all facts and circumstances. Whether or not such reimbursement will be received may be ascertained with reasonable certainty, for example, by a settlement of the claim, by an adjudication of the claim, or by an abandonment of the claim. When a taxpayer claims that the taxable year in which a loss is sustained is fixed by his abandonment of the claim for reimbursement, he must be able to produce objective evidence of his having abandoned the claim, such as the execution of a release.

(ii) If in the year of the casualty or other event a portion of the loss is not covered by a claim for reimbursement with respect to which there is a reasonable prospect of recovery, then such portion of the loss is sustained during the taxable year in which the casualty or other event occurs. For example, if property having an adjusted basis of $10,000 is completely destroyed by fire in 1961, and if the taxpayer's only claim for reimbursement consists of an insurance

claim for $8,000 which is settled in 1962, the taxpayer sustains a loss of $2,000 in 1961. However, if the taxpayer's automobile is completely destroyed in 1961 as a result of the negligence of another person and there exists a reasonable prospect of recovery on a claim for the full value of the automobile against such person the taxpayer does not sustain any loss until the taxable year in which the claim is adjudicated or otherwise settled. If the automobile had an adjusted basis of $5,000 and the taxpayer secures a judgment of $4,000 in 1962, $1,000 is deductible for the taxable year 1962. If in 1963 it becames reasonably certain that only $3,500 can ever be collected on such judgment, $500 is deductible for the taxable year 1963.

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§ 1.172–3 *Net operating loss in case of a taxpayer other than a corporation.*

(a) *Modification of deductions.* A net operating loss is sustained by a taxpayer other than a corporation in any taxable year beginning after December 31, 1953 if and to the extent that, for such year there is an excess of deductions allowed by chapter 1 of the Internal Revenue Code of 1954 over gross income computed thereunder; this rule shall apply even though the loss year is otherwise subject to the Internal Revenue Code of 1939. In determining the excess of deductions over gross income for such purpose—

(1) *Items not deductible.* No deduction shall be allowed under—

(i) Section 151 for the personal exemptions or under any other section which grants a deduction in lieu of the deductions allowed by section 151.

(ii) Section 172 for the net operating loss deduction, and

(iii) Section 1202 in respect of the net long-term capital gain.

(2) *Capital losses.* (i) The amount deductible on account of business capital losses shall not exceed the sum of the amount includible on account of business capital gains and that portion of nonbusiness capital gains which is computed in accordance with paragraph (c) of this section.

(ii) The amount deductible on account of nonbusiness capital losses shall not exceed the amount includible on account of nonbusiness capital gains.

(3) *Nonbusiness deductions*—(i) *Ordinary deductions.* Ordinary nonbusiness deductions shall be taken into account without regard to the amount of business deductions and shall be allowed in full to the extent, but not in excess, of that amount which is the sum of the ordinary nonbusiness gross income and the excess of nonbusiness capital gains over nonbusiness capital losses. See paragraph (c) of this section. For purposes of section 172, nonbusiness deductions and income are those deductions and that income which are not attributable to, or derived from, a taxpayer's trade or business. Wages and salary constitute income attributable to the taxpayer's trade or business for such purposes.

(ii) *Sale of business property.* Any gain or loss on the sale or other disposition of property which is used in the taxpayer's trade or business and which is of a character that is subject to the allowance for depreciation provided in section 167, or of real property used in the taxpayer's trade or business, shall be considered, for purposes of section 172(d)(4), as attributable to, or derived from, the taxpayer's trade or business. Such gains and losses are to be taken into account fully in computing a net operating loss without regard to the limitation on nonbusiness deductions. Thus, a farmer who sells at a loss land used in the business of farming may

in computing a net operating loss, include in full the deduction otherwise allowable with respect to such loss, without regard to the amount of his nonbusiness income and without regard to whether he is engaged in the trade or business of selling farms. Similiarly, an individual who sells at a loss machinery which is used in his trade or business and which is of a character that is subject to the allowance for depreciation may, in computing the net operating loss, include in full the deduction otherwise allowable with respect to such loss.

(iii) *Casualty losses.* Any deduction allowable under section 165(c)(3) for losses of property not connected with a trade or business shall not be considered, for purposes of section 172 (d)(4), to be a nonbusiness deduction but shall be treated as a deduction attributable to the taxpayer's trade or business.

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